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Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1995

B. J. McADAMS, INC., DEBTOR

CONSTELLATION DEVELOPMENT CORP. PETITIONER

v.

JAMES F. DOWDEN, SUCCESSOR TRUSTEE, RICHARD L. SMITH, TRUSTEE AND UNITED STATES EX REL. INTERNAL REVENUE SERVICE RESPONDENTS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, FOR THE EIGHTH CIRCUIT

"PETITION FOR WRIT OF CERTIORARI"
"SEPARATE APPENDIX"

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UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

NO. 94-3658

In re: B. J. McAdams, Inc.	*	
Debtor;	*	
	*	
Constellation Development Corporation	*	
Appellant;	*	Appeal From the United
	*	States Court for the
v.	*	Eastern District of
	*	Arkansas
James F. Dowden, Successor Trustee; United States, ex rel. Internal Revenue Service;	*	
Appellees.	*	

Submitted: June 14, 1995
Filed: September 20, 1995

Before MORRIS SHEPPART ARNOLD, Circuit Judge; and HEANEY and JOHN R. GIBSON, Senior Circuit Judges.

HEANEY, Senior Circuit Judge.

This case appears in our court a second time. In In re B. J. McAdams, Inc., 999 F.2d 1221 (8th Cir. 1993), we reversed on procedural grounds the

district court's dismissal of an appeal by Constellation Development Corporation as untimely filed. On remand, the bankruptcy court held that Constellation's asserted lien against B. J. McAdams, Inc. was null and void. The present appeal presents two issues. First, we must determine whether the trustee in bankruptcy had standing to bring the action below. Second, we review the bankruptcy court's holding that Constellation and several related corporations were the "alter egos" or mere instrumentalities of the debtor, B. J. McAdams, Inc. We affirm on both counts.

I.

This action arises from the involuntary bankruptcy of B. J. McAdams, Inc. ("BJMI"), an insolvent Arkansas trucking enterprise and one of an array of corporate entities created and controlled by Bobby Joe McAdams ("McAdams"). McAdams was the president, chief executive officer, and sole stockholder of BJMI. His son, Robert L. McAdams ("Robert"), held the title of executive vice- president of BJMI. The report of a psychological examiner indicates that Robert "functions in the boderline range of intelligence, likely has difficulty understanding social expectations, may be easily confused, has poor judgment or common sense and likely has minimal capacity for learning any kind of complex task." McAdams stated that Robert was "not capable of taking care of his financial affairs." McAdams and Robert both testified that Robert made neither business nor personal decisions without the advise and assistance of his father, and that he almost always followed his father's instructions.

Beginning in the late 1980s, McAdams formed various corporations in an attempt to reduce BJMI's operating costs. Together, the entities comprised an interlocking web of contracts, agreements, promissory notes, and transfers of funds. Three of these corporations merit close examination.

A.

Parthenon Insurance Company was formed in 1986 under the laws of the British Virgin Islands. Robert has been at various times director, corporate treasurer, and president/secretary of Parthenon. From 1986 to 1988, Parthenon's stock was held by McAdams and Robert. In 1988, Robert owned half and Constellation owned the other half. Because Parthenon owned one hundred percent of Constellation, Robert was effectively the sole owner of both corporations in 1988 and 1989. In March, 1989, Parthenon was purportedly sold in its entirety to Plentywood, Inc., a Panamanian corporation, by means of a stock swap.[1] Through Parthenon, Plentywood would also appear to own one hundred percent of Constellation. All of Parthenon's capital, consisting of two contributions of $125,000 each, came from what

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[1] McAdams testified that he traded one hundred percent of Parthenon and Constellation for ten shares, or roughly ten percent, of Plentywood in Robert's name. McAdams testified further that he had no knowledge of how much the ten shares were worth. We note that despite the purported sale of Parthenon to Plentywood, McAdams later agreed to sell Parthenon to yet a third party, though the deal eventually fell through.

McAdams has labeled Robert's "trust fund." Parthenon appears to have served as a type of self-insurance mechanism for BJMI. By corporate resolution, Parthenon granted BJMI the authority to "appoint such individuals as B. J. McAdams, Inc. deemed necessary to transact certain business matters of the corporation [Parthenon]." Parthenon had no salaried employees, instead relying on BJMI's clerical and administrative staff to perform its corporate tasks. There is no evidence that Parthenon ever compensated BJMI for the services. Throughout its corporate existence, Parthenon never maintained a bank account and conducted all of its transactions by cash or cashier's checks. McAdams agreed in his testimony before the bankruptcy court that he made "all decisions in regard to Parthenon on Robert's behalf."

The nature of the arrangements between BJMI and Parthenon were unusal in many respects. At the outset, BJMI paid Parthenon an insurance premium of $42,000 per month for $500,000 worth of coverage with a $50,000 deductible. All premiums paid prior to November 1987 were refunded to BJMI in full pursuant to a return premium agreement between BJMI and Parthenon. After November 1987, Parthenon refunded only fifty percent of the premiums, retaining the other half to "build up" its capital reserves. The retention appears to have been largely illusory, however, because Parthenon simply held BJMI's uncashed checks. Subsequently, Parthenon converted the uncashed preium checks to cashier's checks and then loaned those funds back to BJMI through Constellation, an entity formally owned by Parthenon. The exact means by which the transfer from Parthenon to Constellation took place remains unclear. McAdams insisted in his testimony that the transfer was not a loan, but rather an

investment governed by the terms of a murky document known as the "Matching Fund and Other Type Loan(s) and Security Agreement." Drafted by McAdams, the Matching Fund Agreement purported to govern secured loan transactions between BJMI and Constellation. In any event, McAdams's claim that we should rely on the Matching Fund Agreement to ascertain the terms of the transfers is undermined by the incoherence of the text of the Agreement, by the fact that McAdams drafted and signed the Agreement on behalf of both BJMI and Constellation, and by McAdams' continued assertion of an interest in Constellation's lien despite the fact that Plentywood now owns both Parthenon and Constellaion.

In mid-1988, the monthly premium paid by BJMI to Parthenon was raised to $52,000, providing $1,000,000 of coverage with a $50,000 deductible. During the months of September through December of 1989, BJMI made no premium payments, instead executing promissory notes in favor of Parthenon. Consequently, Parthenon appears to have lacked the capital reserves to fulfill its responsibilities as an insurer. Evidence before the bankruptcy court indicated that Parthenon failed to pay at least two judgments against BJMI resulting from personal injury lawsuits.

B.

A second corporation created by McAdams was B. J. McAdams Drivers Services, Inc. ("DSI"), an employee leasing entity which leased drivers to BJMI. The record indicates that McAdams was DSI's sole stockholder and that he located DSI in Indiana to take advantage of lower state worker's compensation insurance rates. When DSI was created,

BJMI transferred all of its truck drivers to DSI as part of an arrangement to lease the drivers back to BJMI. DSI had no clients other than BJMI, no payroll department, no capital reserve, owned no real or personal property, and utilized BJMI's dispatcher and administrative staff. The Indiana office of DSI was staffed by two former BJMI employees who had transferred from BJMI's North Little Rock headquarters. When DSI eventually ceased doing business, all of its employees were returned to BJMI's payroll and control. At that time, DSI was significantly deficient on its withholding taxes owed to the Internal Revenue Service.

C.

Central to this appeal is a third entity created by McAdams. Constellation Development Corporation. Incorporated in Delaware in mid-1988, Constellation was entirely owned by Parthenon. At the time Constellation obtained its asserted liens, Robert was the owner of Parthenon and, through it, Constellation. Constellation's sole director was Robert, who also served as president/secretary until March 1990. Constellation had no employees, no staff, no bank account, and no office, and all of its routine clerical functions were performed by BJMI employees. McAdams testified that Constellation was designed to serve as a vehicle to invest Robert's childhood. No written documents evidencing such a trust were presented to the bankruptcy court. The trust corpus allegedly consisted of cash accumulated over the years by McAdams and placed in a lock box in BJMI's main terminal in North Little Rock. At McAdams' direction, $368,500 from Robert's "trust" was used initially to capitalize Constellation. The entire

$368,500 was then loaned back to BJMI.

The loan arrangement was governed by the Matching Fund Agreement, a document drafted solely by McAdams. McAdams signed it on behalf of BJMI, and Robert signed on behalf of Constellation. McAdams testified that the terms were negotiated by him as the representative of both BJMI and Constellation. Pursuant to the Matching Funds Agreement, BJMI executed demand notes payable to Constellation at ten percent interest. To secure the amounts loaned from Constellation to BJMI, security agreements were executed granting Constellation a lien in various real and personal property of BJMI, including a 1977 Gates Learjet 36A. The parties stipulated below that all lien documents were properly recorded in accordance with the applicable state and federal laws. Those documents indicated that Constellation had a lien against the property of BJMI based on principal outstanding on the notes in the amount of $1,344,000, plus accrued interest. Of this amount, $428,000 was attributable to cash insurance premium payments made by BJMI to Parthenon and then loaned by Constellation to BJMI, and $208,000 was based on notes issued by BJMI to Constellation in lieu of making cash insurance premium payments to Parthenon. Of the remainder, Constellation asserts that $112,500 had been provided to it by BJMI to begin with, $368,000 was attributable to the cash used by McAdams to capitalize Constellation initially, and $227,000 was attributable to additional cash from Robert's "trust fund."

In an involuntary Chapter 7 petition brought against BJMI, the United States filed a proof of claim against the estate in the total amount of $1,110,089.34. The bankruptcy court approved the sale of BJMI's 1977 Gates Learjet for $1,562,050.

The trustee commenced adversary proceedings for the determination of the validity, extent, and priority of liens asserted against the proceeds of the aircraft and other property of the estate by, among others, Constellation and the Internal Revenue Service. Constellation did not challenge the validity of the tax liens, but maintained that its lien was entitled to priority because it was filed before the tax liens. The IRS responded that Constellation's lien was invalid because the underlying debt was invalid.

Following an evidentiary hearing, the bankruptcy court found that Constellation's liens were void because Constellation was BJMI's alter ego. The district court affirmed.

II.

Before we reach the merits, we must ascertain, first, whether the trustee in bankruptcy had standing to bring the action below, and second, whether the bankruptcy court had jurisdiction over the case.

First, characterizing the trustee's suit as an alter ego action, Constellation contends that In re Ozark Restaurant Equip. Co., Inc., 816 F2d 1222 (8th Cir.), cert. denied sub nom. Jacoway v. Anderson, 484 U.S. 848 (1987), deprives the trustee of standing to pursue this case in the first instance. In Ozark, this court held that the Bankruptcy Code did not give a Chapter 7 trustee standing to bring an action on behalf of the debtor corporation's creditors. Our analysis rested primarily on the Supreme Court's construction of the statutory plrovisions governing trustees in Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416 (1972), and on Congress's failure to override

Caplin when it overhauled the bankruptcy laws in 1978. Ozark, 816 F2d at 1228; but see Koch Refining v. Farmers Union Cent. Exch., Inc., 831 F2d 1339, 1347 n 11 (7th Cir 1987), cert denied. 485 U.S. 906 (1988) (holding that failure of Congress to adopt bill overruling Caplin "does not affect a trustee's right to bring a general action on behalf of all creditors rather than a personal one on behalf of only some"). We concluded that "Congress's message is clear -- no trustee, whether a reorganization trustee as in Caplin or a liquidation trustee . . . has power under Section 544 to the Code to assert general causes of action, such as the alter ego claim, on behalf of the bankrupt estate's creditors." Ozark, 816 F2d at 1228 (emphasis in original). In Ozark, the trustee initiated an adversary proceeding seeking to pierce the corporate veil in order to hold the debtor corporation's principals personally liable on the corporation's debts. Ozark held that while a trustee can pursue causes of action belonging to the debtor, only the creditors of the corporation can pursue a cause of action belonging exclusively to them. The conceptual rationale underlying Ozark has been summarized by the First Circuit: "The trustee steps into the shoes of the debtor for the purposes of asserting or maintaining the debtor's cause of action, which become property of the estate." In re Rare Coin Galleries of America, Inc., 862 F2d 896, 901 (1st Cir 1988). Looking to state law, Ozark held that an action by certain of a bankrupt corporation's creditors to impose personal liability on the principals for debts owed them by the corporation belongs to those creditors and cannot be maintained by the trustee. Put another way, Ozark stand for the proposition that a corporation cannot pierce its own veil.

The case before us is easily distinguishable from Ozark. We are not confronted with an alter ego action brought by the trustee in an effort to pierce BJMI's corporate veil and hold its principals personally liable on its debts. Rather, the trustee sought a judicial determination of the validity, extent, and priority of competing liens asserted against property of the bankrupt estate, including those of Constellation and the IRS. We find express authorization for such actions at 28 USC §§ 157(b)(1) and 157(b)(2)(K) and under Federal Rule of Bankruptcy Procedure 7001(2). In the proceeding below, the alter ego issue was raised by a competing creditor -- the IRS -- and not by the trustee. The IRS asserted the alter ego theory as a defense to the amended cross-claim filed against it by Constellation. Ad a competing creditor, the IRS occupies a very different position from the trustee. None of the statutory or purdential considerations confining the powers of trustees in Ozark and Caplin imposes a parellel limitation on the ability of a creditor to seek the invalidation of a competing lien. Accordingly, we find that the trustee had standing to bring the action below.

Second, Constellation asserts that the bankruptcy court lacked jurisdiction over the trustee's action because the liens asserted against the aircraft exceeded its value. Constellation appears to suggest that because the proceeds of the airplane sale were insufficient to satisfy all the liens asserted against it, the estate, in effect, had no property over which the court could exercise jurisdiction. This agrement borders on the frivolous. An action to determine the validity, extent, or priority of liens asserted against the property of a bankrupt estate is a core proceeding under 28 USC §§ 157(b)(1) and 157(b)(2)(K). As the

Seventh Circuit has stated, "resolving competing claims to property that belonged to the debtor when it filed a petition in bankruptcy is one of the central functions of bankruptcy law." In re Xonics, Inc., 813 F2d 127,131 (7th Cir 1987). Here we need only ask whether the aircraft and its proceeds were property of the estate. Under 11 USC § 541(a)(1), the property of the estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case." See, generally, United States v. Whiting Pools, Inc., 462 U.S. 198, 203-05 (1983); Missouri v. Bankruptcy Court, 647 F2d 768, 774-75 (8th Cir 1981), cert denied, 454 U.S. 1162 (1982). In addition, 11 USC § 541(a)(6) makes clear that proceeds generated from the sale of property of the estate remain property of the estate.

Because BJMI unquestionably held title to the aircraft at the commencement of the bankruptcy case, it follows that the proceeds from its sale were property of the estate. Bankruptcy court jurisdiction is not defeated where the aggregate amount of liens asserted by all parties exceeds the value of the property of the estate. Similarly, jurisdiction will not retroactively evaporate at the conclusion of a proceeding in which the bankruptcy court ascertains that the property of the estate is insufficient to satisfy all valid liens in full. Constellation's suggestion to the contrary betrays a profound misunderstanding of the basic concepts underlying federal jurisdiction. Here, the fact that the liens eventually found valid by the court exceeded the amount of the proceeds simply reflects the result of the court's exercise of jurisdiction; it does not mean that the court lacked jurisdiction at the outset.

We conclude that the district court's exercise

of jurisdiction was proper.

III.

Turning to the merits of the appeal, Constellation asserts that the bankruptcy court made twenty-three errors in its findings of fact. Most of these asserted errors concern tangential facts that were the subject of conflicting testimony and documentary evidense; nore appears to have any bearing on the ultimate disposition of the case. We echo the observation of an earlier panel in the Ozark saga: The appellants' argument "amounts to nothing more than an attempt to reargue facts decided by the bankruptcy court." In re Ozark Restaurant Equip. Co., Inc., 850 F2d 342,346 (8th Cir 1988). Having carefully reviewed the record, we find no clear error in the bankruptcy court's findings of fact.

Moreover, we affirm the bankruptcy court's determination that Constellation constituted a mere alter ego of the debtor corporation. In view of the bankruptcy court's well-reasoned and thorough order, we need highlight only the most important of the facts dictating our conclusion. The heart of the issue is whether Constellation was so dominated by BJMI and McAdams that its corporate form must be disregarded and its liens be held void. "[A] bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence." Pepper v. Litton, 308 U.S. 295, 305 (1939). "The conditions under which the corporate entity may be disregarded or looked upon as the alter ego of the principal stockholder vary according to the circumstances of each case." Humphries v. Bray, 611 SW2d 791, 793(Ark App 1981).

Where a corporate form is challenged, "the real basis of liability is actual control and manipulation of the other, whether that control and manipulation be exercised by virtue of stock ownership or otherwise." Henderson v. Rounds & Porter Lumber Co., 99 F Supp 376 (W.D. Ark 1951). The Arkansas Supreme Court has admonished:

> One of the surest indications of such abuse, however, is the fact that the executives of the subsidiary, instead of acting independently in its interests, take their orders from the parent corporation in the latter's interest . . . . [D]irectors cannot lawfully manage the affairs of one of the corporations in the interest of the other.

Rounds & Porter Lumber Co. v. Burns, 255 SW2d 1, (Ark 1949).

Under the alter ego doctrine, the legal fiction of the separate corporate entity may be rejected in the case of a corporation that (1) is controlled by another to the extent that it has independent existence in form only, and (2) is used as a subterfuge to defeat public convenience, to justify wrong, or to perpetuate a fraud. Lakota Girl Scout Council, Inc. v. Havey FundRaising Management, Inc., 519 F2d 634, 638 (8th Cir 1975). "The essence of the [alter ego] test is whether, under all the circumstances, the transaction carries the earmarks of an arm's length bargain. It is does not, equity will set it aside." Pepper, 308 U.S. at 307. A bankruptcy claim by an alter ego should be disallowed to prevent injustice.

We agree with the bankruptcy court's conclusion that Constellation's lien was not founded on any true debt. The financial transactions giving rise to Constellation's

asserted lien bore none of the features of an arm's-length bargain. The record demonstrates that Parthenon owned Constellation, that Robert owned Parthenon, and that McAdams exercised total control over the business decisions of Robert. During the period relevant to this appeal, no one other than McAdams and Robert held an ownership interest in BJMI, Constellation, DSI and Parthenon. To simplify the chain somewhat, the record indicates that money flowed from BJMI to Parthenon, from Parthenon to Constellation, and from Constellation back to BJMI. More specifically, BJMI paid insurance premiums to Parthenon. At first, Parthenon refunded all the BJMI's payments. Later, Parthenon retained half of the premium, holding it in the form of uncashed checks. A portion of that money was eventually transferred to Constellation, which in turn loaned it to BJMI in exchange for a lien on the Learjet. Though purportedly an insurance company, Parthenon's only capital consisted of uncashed premium checks and liens in the property of its sole insured, BJMI. Constellation functioned only to make loans to BJMI in exchange for a security interest in the Learjet and other assets. As Constellation acknowledges, it needed no management or clerical staff because it simply loaned all of its funds to BJMI. McAdams alone negotiated, drafted, and signed the Matching Fund Agreement on behalf of both BJMI and Constellation -- a curious arrangement in light of the fact that McAdams was neither an officer nor a director of Constellation, and owned no shares of its stock. As was the case in In re Distrigas Corp., 75 B.R. 770, 773 (Bankr.D.Mass. 1987), "[u]nless the left hand is independent of the right hand, there [was] no arms'length bargaining."

The evidence established that Constellation

was controlled by BJMI, that it had independent existence in form only and that it was thus the mere insturmentality or alter ego of BJMI. As the bankruptcy court found, Constellation was incorporated at the behest of McAdams and, in reality, controlled by him. All of Constellation's funds were provided by McAdams pursuant to his instructions. Neither Constellation nor Parthenon had any reportable income. All their expenses appear to have been paid by BJMI. For example, the evidence showed that a North Little Rock terminal property allegedly owned by Constellation was actually purchased with funds from BJMI without any corresponding from Constellation to BJMI. Likewise, McAdams testified that Constellation's litigation costs were funded out of Robert's "trust fund," even though Constellation now purports to be owned by Plentywood, the Panamanian entity.

In sum, we find that the evidence firmly establishes that McAdams attampted to shelter BJMI's assests from its creditors by means of a self- imposed lien. We agree with the conclusion of the bankruptcy court that "McAdams completely controlled the stock ownership, the officers, the directorships, the finances, the policies and practices, and every other corporate function without regard to any corporate formality." In such circumstances, it would have been inequitable to allow BJMI to deplete the estate by paying itself at the expense of its true creditors.

Accordingly, we affirm the order of the district court in its entirety.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS,
EIGHTH CIRCUIT.

FILED
U.S. DISTRICT COURT
EASTERN DISTRICT ARKANSAS
MAR 25 1994
JAMES W. McCORMACK, CLERK
By: Dep CLerk

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

CONSTELLATION DEVELOPMENT CORP. APPELLANT

vs. No. LR-C-91-634

RICHARD L. SMITH, Trustee and
UNITED STATES EX REL, INTERNAL
REVENUE SERVICE APPELLEE

MEMORANDUM AND ORDER

Constellation Development Corporation appeals from the decision by the Bankruptcy judge,[1] in which he found that appellant, Parthenon Insurance Company, Ltd., and Drivers Services, Incorporated, were alter egos of the debtor, declaring them "invalid and void as a mere sham." The standard review is not in dispute: This Court reviews the bankruptcy judge's factual findings under a clearly erroneous standard and conclusions of law de novo. In re: Muncrief, 900 F2d 1220 (8th Cir 1990).

Applying the appropriate standard, and after a

[1]The Hon. William A. Hill, United States Bankruptcy Judge for the District of North Dakota, sitting by designation.

review of the record, this Court cannot find that the bankruptcy judge's findings of fact are clearly erroneous. Accepting those findings, the Court must agree with the conclusions of law. Two things clearly stand out from the record and, in this Court's mind, compel not only an affirmance of the bankruptcy judge's decision but were obviously compelling to the bankruptcy judge in making his decision. First, was the fact that debtor's principal, B.J. McAdams, placed his son Robert McAdams in positions, the titles of which would indicate management and authority when, in fact, Robert McAdams operated at a very low level of intelligence and could not, and did not, make any significant decisions in business or in his life on his own. Second, the "trust fund" that B.J. McAdams created for Robert, the money from which was used extensively to effectuate the purposes of debtor's design, turned out actually to be several hundred thousand dollars secreted away in a lock box at debtor's place of business. These are not the only indicia of later ego status apparent from the record, but they are the most compelling.

Accordingly, the Memorandum and Order entered in this case on June 13, 1991, is affirmed and Judgment will be entered accordingly.

It is so ORDERED this 24th day of March, 1994.

Stephen M. Reasoner
U. S. DISTRICT JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

IN RE:

B. J. McAdams, Inc.,
Debtor.

Case No. 90-40695F
Chapter 7

Richard L. Smith, Trustee,
Plaintiff,

vs.

Constellation Development, Inc.,
and United States of America,
Internal Revenue Service.
Defendants.

Adv. No. 90-4207

FILED
U.S. BANKRUPTCY COURT
EST & WST DISTS OF ARK
JUNE 13 1991
PEGGY CARROLL, CLERK
By: Dep CLerk

MEMORANDUM AND ORDER

By Complaint and Amended Complaint filed on December 3, 1990, and January 18, 1991, respectively, Richard L. Smith, Trustee for the

Entered on docket on 6/14/91 by ____ in compliance with FRCP 5808(e) and/or FRCP 58, 79(a).

Estate of B. J. McAdams, Inc., seeks a determination of the nature, extent and calidity of liens claimed against certain assets of the estate or proceeds from the sale of those assets. The defendant, Constellation Development, Corp., generally denies the trustee's allegations and counterclaims and cross-claims against the trustee

and other defendants, contending that its liens is prior and paramount to all other liens. The defendant, Internal Revenue Service, claims its tax lien to be superior to that of all lien claimants. The defendant, Union National Bank, was dismissed prior to trial by agreement of the parties. Based upon the evidence producted at trial and the "Joint Stipulation of All Uncontested Facts" the court makes the following findings of fact and conslusions of law.

FINDINGS OF FACT

1.

The Debtor, B. J. McAdams, Inc. (BJM, Inc.), an Arkansas corporation was in the over-road interstate trucking and transportation industry with a nationwide operation. The main terminal for the operation was North Little Rock, Arkansas. The sole stockholder and president/C.E.O. of BJM, Inc. was Bobby Joe McAdams (McAdams). The executive vice-president of BJM, Inc. was McAdams' son, Robert L. McAdams (Robert). Robert was evaluated to be operating on a borderline range of intelligence. According to a psychological examiner, Robert's skills and arithmetical reasoning, concentration, judgment or common sense, and abstract problem solving are very low, even below the borderline range of intelligence. Both Robert and McAdams testified that Robert has never made a personal or business decision without assistance from McAdams. During its peak, BJM, Inc. had a fleet of over 500 trucks and was gorssing fifty million dollars annually. The business started declining in approximately 1980 because, according to McAdams, the implementation

of trucking de-regulation.

In the latter part of the 1980's McAdams, individually, formed various entities which had significant and extensive business involvement with the Debtor, BJM, Inc.. All entities were incorporated at the behest of McAdams for various business reasons.

2.

The first entity formed was entitled Parthenon Insurance Company, Ltd. (Parthenon) with Articles of Incorporation dated April 29, 1986. Parthenon Insurance Company, which was initially called American Centennial Insurance Company, Ltd., was of off-shore corporation incorporated under the Laws of the British Virgin Islands. The director and president/secretary of Parthenon was Robert L. McAdams. Robert was president from May 8, 1986, until February 1, 1990. Robert was also a director of the corporation durine that time period. McAdams was also a director of Parthenon and the corporate treasurer from May 8, 1986, thru March 23, 1989. The present directors of Parthenon are individuals named, Alvaro Higiuero, and Maria Elena DeLaro, both residents of Panama. Mr. Higiuero is also the present C.E.O.. Parthenon's stock ownership has changed several times since its initial inception. Originally Parthenon was owned fifty percent by Robert and fifty percent by McAdams. Then in June of 1987, Robert owned eighty percent and McAdams owned the remaining twenty percent of the stock. The in June of 1988, Robert again owned fifty percent and Constellation Development Corp. (CDC) owned the other fifty percent of the stock. CDC and its relationship to the Debtor and the other entities will be discussed

below. Presently, Parthenon is one hundred percent owned by Plentywood, Inc., a Panamanian corporation. Parthenon was initially capitalized by $125,000.00 cash from Robert's "trust fund". Another $125,000.00 cash was subsequently contributed by Robert from the same "trust fund".

Parthenon, as an alien insurer, was established by McAdams as part of a self retention insurance (S.R.I.) program. Insurance premiums were a major expense of BJM, Inc. in the late 1970's and early 1980's. In order to provide insurance coverage and reduce expenses, McAdams received advice on establishing an S.R.I.. S.R.I.'s are generally used in high risk industries where premium and claim adjustment costs are a significant expense. Through an S.R.I. an insured generally has a high deductible and either performs claim adjustments "in house" or through a claim adjusting service. S.R.I.'s with high deductibles are really just "self insurance". This self insurance was exactly what BJM, Inc. was attempting to set up when Parthenon was created.

By corporate resolution, Parthenon agreed to grant BJM, Inc., neither a shareholder, director nor officer, certain powers to control Parthenon. BJM, Inc. was authorized to "appoint such individuals as B. J. McAdams, Inc. deemed necessary to transact business matters of the corporation [Parthenon]". In addition, Parthenon utilized BJM, Inc. clerical and administrative staff for its individual corporate needs. Parthenon had no salaried employees. There is no evidence before the court concerning whether BJM, Inc. was ever paid by Parthenon for the services.

BJM, Inc. began paying Parthenon an insurance premium of $42,000.00 per month for $500,000.00 worth of coverage with a $50,000.00 deductible.

All premiums paid prior to November 1987 were refunded 100% to BJM, Inc. pursuant to a return premium agreement between BJM, Inc. and Parthenon. After November of 1987, fifty percent of the premiums were refunded to BJM, Inc. and fifty percent of the premiums were retained by Parthenon for a "build up" of its capital reserves. However, this retention of one-half premium was merely Parthenon holding uncashed checks of BJM, Inc.. Subsequently, these uncashed checks were converted to cashiers checks and eventually loaned back to BJM, Inc. through CDC and pursuant to the Matching Funds Agreement.[1] In mid-1988, Parthenon raised its monthly premium to $52,000.00 with excess coverage of $950,000.00, or in other words, $1,000,000.00 of coverage with a $50,000.00 deductible to be paid by the insured, BJM, Inc.. During the months of September, October, November and December 1989, in lieu of making premium payments, BJM, Inc. executed promissory notes in favor of Parthenon. The $208,000.00 worth of promissory notes were allegedly secured by collateral under the "Matching Fund Agreement" with

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[1] The "Matching Fund Agreement" is a contract between BJM, Inc. and CDC which outlined the rights and duties of the parties concerning various loand and financial accommodations. The agreement provides for the loaning of money to BJM, Inc. in return for varous security arrangements. The Matching Funds Agreement also consists of the return premium agreement between Pathenon and BJM, Inc. In addition to Matching Fund Agreement provided that BJM, Inc. could acquire CDC at any time on terms favorable to CDC. See Trustee's Exhibit 2.

CDC.

As the evidence reveals, BJM, Inc. had a least two judgments against it for personal injury suits. Neither judgment was paid by Parthenon because of a hold harmless clause in the insurance agreement between BJM, Inc. and Parthenon. Moreover, one of the judgments went unpaid and was eventually satisfied by the injured persons uninsured motorist policy.

Throughout its existence, Parthenon never maintained a bank account and transacted all of its transactions through case or cashier's checks.[2]

3.

In another apparent cost-saving attempt, McAdams created another corporation entitled B. J. McAdams Drivers Services, Incorporated (DSI). DSI was an employee leasing entity which leased drivers to BJM, Inc.. DSI was located in Indiana in order to take advantage of more favorable state workmen's compensation insurance rates. DSI was incorporated in June of 1986. The sole stockholder of DSI was McAdams. Sometimes Robert would sign DSI related documents on his father's behalf.

At this time DSI was created, BJM, Inc.

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[2]The Debtor, BJM, Inc. and all of its affiliates, CDC, Parthenon, DSI, conducted almost all of their business by cash or cashier's checks. The IRS produced a significant amount of testimony concerning a number of cashier check transactions under the sum of $10,000.00. However, the IRS does not appear to be basing its tax claim on the failure of the Debtor to meet any cash transaction reporting (CTR) requirements.

transferred all of its truck drivers to DSI with an arrangement to lease the drivers back to BJM, Inc.. There is no evidence that DSI drivers worked for anyone other than the Debtor, BJM, Inc.. DSI had no payroll department, no capital reserve, owned no real or personal property, and utilized dispatcher and administrative staff of BJM, Inc.. Two former B. J. McAdams, Inc., employees manned the DSI office in Indiana. Eventually, DSI ceased doing business and all employees (drivers) were returned to BJM, Inc., DSI was significantly deficient on its withholding taxes owed to the IRS. There was no evidence before the court that indicates DSI held annual meetings or met other significant corporate formalities.

The final entity created was Constellation Development Corporation (CDC) which was incorporated in the state of Delaware on June 23, 1988. The initial sole director of Constellation Development Corporation was Robert McAdams. Robert was also the president/secretary until March 14, 1990. The stock of CDC is one hundred percent owned by Parthenon Insurance Company. McAdams testified that the purpose of CDC was to serve as a vehicle to invest Robert's money which was set aside in the "trust fund", initially established in Robert's childhood. No written documents evidencing such a trust ever existed. The trust corpus consisted of cash accumulated over the years by McAdams and placed in a lock box in the BJM, Inc. main terminal in North Little Rock. Apparently the trust had accumulated over $300,000.00 and McAdams was looking for a safe investment. McAdams testified that he did not trust the banking industry's financial security due to his upbringing during the depression when many banks failed. Therefore, McAdams felt that a lock

box/safe in the BJM, Inc. office was a more secure place for over $300,000.00 in cash than any financial institution.

By McAdams' directions, $368.500.00 from Robert's "trust" was used to initially capitalize CDC. The entire $368,500.00 was then loaned back to BJM, Inc. pursuant to the Matching Fund Agreement.

The Matching Fund Agreement effective as of June 23, 1988, was signed by McAdams on behalf of BJM, Inc., as president.C.E.O.. All documents between BJM, Inc. and CDC were drafted and negotiated by McAdams individually. Even if executed by Robert, McAdams testified that the terms were negotiated by him representing both BJM, Inc. and CDC on behalf of Robert.

Pursuant to the Matching Fund Agreement, BJM, Inc. executed demand notes payable in favor of CDC at ten percent interest. In order to secure the amounts loaned from CDC to BJM, Inc., security agreements were executed granting CDC a lien in various real and personal property of the Debtor, including but not limited to a 1977 Gates Learjet 36A, serial number 032. The parties stipulated that all lien documents were properly recorded in accordance with the various state and federal law.

CDC had no salaried employees and all administrative, accounting, legal, and secretarial services were provided by BJM, Inc.. CDC is presently one hundred percent owned by Plentywood, Inc.. The present directors of CDC are Regina Cardoze and Maria Elena DeLara. The current president/C.E.O. of CDC is Regina Cardoze. Ms. Kathy Ferguson, a former BJM, Inc. administrative assistant, is now executive vice-president of CDC in charge of overseeing the litigation.

BJM, Inc.'s primary lender was the Maryland

National Bank. In December of 1989, the Maryland National Bank started a replevin action against the accounts receivable and other assets of BJM, Inc.. The Maryland National Bank was successful which essentially froze all accounts of BJM, Inc.. On January 25, 1990, McAdams on behalf of BJM, Inc., entered into a sales agreement with Mr. Paul St. Hilaire and others wherein McAdams purported to sell all stock in BJM, Inc. and "subsidiaries/ affiliated companies" DSI and Parthenon. CDC was also sold to Plentywood, Inc. on apparent stock swap. In exchange for all of his stock in CDC, Robert received ten percent stock in Plentywood, Inc., a Panamanian corporation. The stock is "bearer stock". The sale of CDC to Plentywood was negotiated by McAdams. No witness has ever met anyone now in control of CDC. The money to defend the present lawsuit came from Robert's "trust fund" not Plentywood, Inc. which is CDC's sole shareholder.

On March 28, 1990, unpaid wage claimants of BJM, Inc. filed an involuntary Chapter 7 Petition against the Debtor. The Debtor, BJM, Inc., was adjudicated bankrupt and an order for relief was filed on May 2, 1990.

The trustee has liquidated certain property of the Debtor, including a 1977 Gates Learjet. The sale of the Learjet was approved at $1,562,050.00. The personal property liquidated consisted of vehicles, salvage, scrap, office furnishings and equipment. In addition the trustee is seeking to liquidate various real property holdings of the Debtor.

By virtue of the "Matching Fund Agreement", CDC claims it advanced or loaned the following amounts to BJM, Inc.:

$1,136,000	cash proceeds from cashier's checks
208,000	(4) insurance premium notes to Parthenon
141,849	accrued and unpaid interest
$1,485,849	Total Claims

CDC claims an aircraft lien in the Gates Learjet and a security interest in office furnishings, furniture, inventory, equipment and other personalty. The trustee does not dispute that CDC'ssecurity interests were duly recorded in accordance with state and federal law.

The IRS properly filed Notices of Federal Tax liens on various property of the Debtor including but not limited to the Gates Learjet. The IRS' total claim against the Debtor is in the amount of $1,110,089.34.

Conclusions of Law

1.

This action was initiated by the trustee to determine the nature, extent and validity of certain liens, namely, the extent of CDC's lien, if any, in the proceeds of certain assets of the Debtor, B.J. McAdams, Inc.. The trustee asserts that CDC and Parthenon were so dominated by BJM, Inc. and primarily, McAdams himself, that the corporate entities should be disregarded and the validity of the secruity interest of CDC should be negated as invalid. The defendant, I.R.S., generally asserts the same contentions reasoning that the corporate entities of CDC, Parthenon, and DSI's tax delinquencies are recoverable from B.J. McAdams, Inc. because DSI is the alter ego or a mere instrumentality of the Debtor. In addition,

the I.R.S. asserts that the employees of DSI were always under the sole control of BJM, Inc.. The trustee produced no evidence that the I.R.S.'s tax lien is somehow invalid. The defendant contends that all entities were separate and distinct corporations and that CDC's lien is valid and superior to that of all parties. Thus, the validity of CDC's lien is conditional upon the determination of whether CDC is a separate and distinct corporation or merely an instrumentality or "alter ego" of the Debtor.

2.

Generally, courts will and must respect separate corporate existence, but when under the facts of a particular case and the administration of justice so requires, the fiction of corporate legal entity may be brushed aside and responsibility placed where it belongs. Henderson v. Rounds & Porter Lumber Company, 99 F. Supp. 376, 381 (W.D.Ark. 1951), Green v. Equitable Powder Mfg. Co., 95 F. Supp. 127, 131 (W.D.Ark. 1951); See also Hackney Precision Products, Inc. v. American Alloys Corp., 422 F.2d 1395, 1398 (8th Cir. 1970); National Dairy Product Corp. v. U. S., 350 F.2d 321, 327 (8th Cir. 1965); Starr Farms, Inc. Southwestern Electric, 607 S.W.2d 391 (Ark. 1980); Woodyard v. Arkansas Diversified Inc., 594 S.W.2d 13 (Ark. 1980). It has been generally recognized that:

> When, as against the general rule that two separately incorporated companies are separate and distinct entities, it is charged that one is a mere agency or department of the other and is used as an instrumentality to perpetuate fraud,

> justify wrong, avoid litigation or render it more difficult, or generally to escape liability for what are in substance its own acts, courts will put aside the screen and, looking upon the situation through the group of negative rules, determine affirmatively the truth and place responsibility where it actually belongs.

Henderson v. Rounds & Porter Lumber Co., 99 F. Supp. 376, 381 (W.D. Ark. 1951). The conditions under which corporate entities may be disregarded or corporations looked upon as alter ego of principal or stockholder, or the subsidiary as an alter ego of the parent, vary according to the particular circumstances. Aetna Casualty and Surety Company v. Stover, 327 F. Supp. 288 (8th Cir. 1984). The doctrine of disregarding a corporate entity is founded in equity and is applied only when facts warrant its application to prevent an injustice. Id.

In determining whether to disregard the corporate form courts have almost universally adopted a similar set of factors which may establish that one corporate entity is a mere "alter ego" or "instrumentality" of the dominant corporation. The "instrumentality" exception arises where one corporation totally dominates and controls a subservient corporation in such a way that the subservient corporation is operated as a business conduit or agent of the dominant corporation. U.S. v. Jon-T Chemicals, 768 F.2d 686, 689 (5th Cir. 1985).

> The control required for liability under the "instrumentality" rule amounts to a total domination of the subservient corporation, to the extent that the subservient corporation manifests no

> separate corporate interest of its own and functions solely to achieve the purposes of the dominant corporation.

Id.

As one commentator stated:

> The control necessary to invoke what is sometime called the "instrumentality rule" is not mere majority or complete stock control but such domination of finances, policies and practices that the controlled corporation has, so to speak, no separate mind, will or existence of its own and is but a business conduit for its principal.

Id. citing 1 W. Fletcher, Cyclopedia of the Law of Private Corporations, section 43 at 204-05 (1963); Krivo Industrial Supply Company v. National Distillers & Chemical Corp., 483 F.2d 1098, 1106 (5th Cir. 1973).

While CDC, Parthenon and DSI are not necessarily subsidiaries of the Debtor, all of the entities' stockholders were also officers and directors of BJM, Inc. Moreover, CDC, is a subsidiary of Parthenon Insurance. The fact that CDC, Parthenon, and DSI were all so interrelated with BJM, Inc., the court finds the factors utilized to determine whether a subsidiary is the alter ego of its parent very instructive and indicative of whether CDC, Parthenon, and DSI were merely alter egos or instrumentalities of the Debtor, BJM, Inc..

See In re Tryit Enterprises, 121 B.R. 217, 223 (Bankr. S.D. Tex 1990).

The laundry list generally used by the courts is as follows:

1. The parent and subsidiary have common stock ownership;
2. The parent and subsidiary have common

directors or officers;

3. The parent and subsidiary have common business departments;
4. The parent and subsidiary file consolidated financial statements and tax returns;
5. The parent finances the subsidiary;
6. The parent caused the incorporation of the subsidiary;
7. The subsidiary operates with grossly inadequate capital;
8. The parent pays the salaries and other expenses of the subsidiary;
9. The subsidiary receives no business except that given to it by the parent.
10. The parent uses the subsidiaries' property as its own;
11. The daily operations of the two corporations are not kept separate;
12. The subsidiary does not observe the basic corporate formalities such as keeping separate books and records and holding shareholder and board meetings.

U.S. v. Jon-T Chemicals, 768 F.2d 686, 691-92 (5th Cir. 1985).

In the present case, and during all relevant time periods, the stock ownership in the Debtor, BJM, Inc., Parthenon, CDC, and DSI, was all owned by only two individuals, either B.J. McAdams, president/CEO of the Debtor, or Robert L. McAdams, executive-vice president of the Debtor. The directors or officers of all the entities were either McAdams or Robert.[3] Robert was president of CDC and president of Parthenon. An additional concern in the present case is the ability of the officers to meet the duties and responsibilities of their position. Robert is and was not mentally

capable of managing entities of a complex nature like CDC and Parthenon. CDC claimed to have held assets worth over $1,000,000.00 and Parthenon was an insurance provider with $950,000.00 of excess coverage for its insured. All agreements, written or oral, between CDC, Parthenon, DSI, and BJM, Inc., were all negotiated and drafted by McAdams for both parties concerned. McAdams testified that he would negotiate on behalf of CDC and Parthenon. However, McAdams never owned stock in CDC nor was he a director or officer of the corporation. He testified that he was negotiating on Robert's behalf. Therefore, it is apparent that McAdams was in control of every decision either daily operational or long term planning of both CDC and Parthenon. Since he was the 100% shareholder of DSI, it goes without mentioning the control McAdams maintained over DSI.

As for the financing of the entities, the testimony establishes that all expenses of CDC, Parthenon, and DSI came from McAdams. None of the entities had any reportable income. While DSI allegedly had truck drivers in their employ, Parthenon and CDC had no salaried employees. The Debtor, BJM, Inc., provided all necessary clerical and administrative services for CDC, Parthenon, and DSI.

CDC, Parthenon, and DSI were all incorporated at the behest of McAdams, the 100% shareholder of the Debtor. In addition, the entities were created to provide financing, insurance, and employees solely to, and for the benefit of, the Debtor, BJM, Inc..

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[3]The directorships and officers of CDC and Parthenon changed upon its sale to Plentywood, Inc.

All of the entities, CDC, Parthenon, and DSI operated with grossly inadequate capital. The only assets held by CDC were alleged liens in the Debtor's property and demand notes executed by BJM, Inc. Parthenon's capital consisted of liens in the Debtor's property and uncashed premium checks and promissory notes. Parthenon was an insurance provider with $950,000.00 of excess coverage. Yet Parthenon's solvency was inextricably tied to the solvency of its insured, BJM, Inc.. If for any reason BJM, Inc. lost the assets pledged to CDC, Parthenon would be incapable of paying any claims. The type of "investments" held by Parthenon are not the type of safe investments one thinks of when determining an insurance company's asset base. As for DSI, the court is unaware of any evidence establishing that DSI had any capitalization, in addition to the $1,000.00 initially contributed by McAdams. Thus, the court believes that Parthenon, CDC, and DSI were all undercapitalized.

BJM, Inc. provided all expenses for these entities. There is no evidence before the court that these entities had any income in which to pay expenses. In fact, the testimony establishes that payments for the North Little Rock terminal property allegedly owned by CDC were actually made by BJM, Inc. without corresponding repayment to BJM, Inc. from CDC. All clerical and administrative services were provided by BJM, Inc. for all entities. While CDC and Parthenon had no salaried employees, Robert received a salary from BJM, Inc.. Furthermore, McAdams testified that the expense of this litigation is being paid from Robert's "trust fund" in order to defend CDC's claims. This is quite confusing if Plentywood is the 100% shareholder of CDC. However, it further evidences McAdams' manipulation of entities and

disregard for corporate formalities.

As established earlier, Parthenon, CDC, and DSI, had no other customers, clients, or business, that was not generated by the Debtor, BJM, Inc.

While there is evidence of some corporate formalities maintained by CDC and Parthenon (i.e., minutes of corporate meetings, corporate resolutions, and some books and records) the court is unpersuaded that these actions constitute observing the corporate separateness of the entities. These corporate meetings could not have been held with any earnest. Robert is incapable of understanding or comprehending the result or consequences of these meetings. Thus, if the meetings were held they were probably at the direction of McAdams and for the sole purpose of benefiting the Debtor, BJM, Inc.. An alter ego action depends upon the totality of the facts. U.S. v. Jon-T Chemical, Inc., 768 F.2d 686,694 (5th Cir. 1985). In applying the "instrumentality rule" or the alter ego doctrine, courts are concerned with reality and not form or more specifically, how the entities operated with each other. Id . at 693. The entities "must be more than a corporate charter embellished by a few formal niceties." Id. A court "cannot as in the case of the Emperor's New Clothes pretend to see something which does not exist". Id.

In the present case, CDC, Parthenon, and DSI were completly dominated by McAdams and thus, BJM, Inc.. They were created by McAdams for the sole benefit of the Debtor, BJM, Inc.. Any monies generated or inserted into the entities were loaned back to the Debtor in order to help the Debtor's precarious financial position. All of the entities were undercapitalized and had no private corporate agenda separate from the Debtor. Where an entity

establishes another entity, under capitalizes, and dominates it to such an extent that it is a mere conduit for the creating entity's business, the corporate barriers should be disregarded. Id. The court is of the opinion, that an entity whose president was an individual who is mentally challenged and incapable of undertaking the responsibilities of his office or understanding the consequences of his actions could not be an entity separate from the controlling force behind the creation of that entity. There is no litmus test for determining whether an affiliate corporation is the alter ego of another corporate entity. Instead, the court must look to the totality of the circumstances. Based upon a totality of the facts, it is clear that CDC, Parthenon, and DSI, were so dominated and controlled by the Debtor, BJM, Inc., through its president, McAdams, that none of the affiliated entities had any corporate purpose of their own separate from the Debtor. McAdams completely controlled the stock ownership, the officers, the directorships, the finances, the policies and practices, and every other corporate function without regard to any corporate formality. Therefore, this court will find that CDC, Parthenon, and DSI were all "alter egos" or a mere instrumentalities of the Debtor, BJM, Inc.. As such, the loans and security arrangement between CDC and McAdams should be declared invalid and void as a mere sham.

The I.R.S. filed a tax lien against the Debtor's property in order to collect on delinquent tax obligations of DSI, inter alia. Accordingly, because DSI is determined to be the alter ego of the Debtor, BJM, Inc., its tax delinquencies may be recovered from BJM, Inc.. Thus, because the I.R.S.

has properly filed tax liens against the property that is the subject of this action, those liens are determined valid.

Accordingly, and for the reasons stated above, the lien of Constellation Development Corporation is declared null and void. The lien of the I.R.S. is determined to be a valid tax lien against the proceeds of the Debtor's, B.J. McAdams, Inc., property.

LET JUDGEMENT BE ENTERED ACCORDINGLY.

Dated this 10th day of June, 1991.

_____

WILLIAM A. HILL
United States Bankruptcy Judge
sitting by special designation

cc: James Smith, Esq.
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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

IN RE:

FILED
92 July - 1 AM 11:00

B. J. McAdams, Inc.,
Debtor. Bankruptcy No. 90-40695 F

Richard L. Smith, Trustee,
Plaintiff,
v.

Union National Bank of Little Rock, Constellation Development Corporation and United States of America,
Defendants. Adversary No. 90-4189

MEMORANDUM AND ORDER

By Amended Complaint filed January 18, 1991, Richard L. Smith, Trustee for the Estate of B. J. McAdams, Inc., seeks to determine the nature, extent and validity of any liens asserted by the defendant, Constellation Development Corporation, Inc., and the United States of America through the IRS, in the proceeds of a 1977 Gates Learjet 36(A) liquidated by the Trustee.

After concluding there to be common questions of fact and law, this case was consolidated for trial with adversary proceeding No. 90-4207 entitled Richard L. Smith, Trustee, Plaintiff v. Constellation Development Corporation, Inc. and United States of America, Internal Revenue Service.

In that case, the Trustee sought to determine the nature, extent, and validity of any liens claimed by the defendants, Constellation Development Corporation, United States of America, Internal Revenue Service, in any net proceeds from the sale of personalty located on the premises of the Debtor, B.J. McAdams, Inc.. This court previously rendered a Memorandum and Order in adversary proceeding 90-4207, dated June 10, 1991. The reasoning of the Memorandum and Order in adversary proceeding No. 90-4207, dated January 10, 1991, is hereby adopted by reference and will serve as the court's findings of fact and conclusions of law in the instant adversary proceeding No. 90-4189, with the conclusion being that defendant, Constellation Development Corporation is an alter ego of the Debtor, B.J. McAdams, Inc.. Constellation Development Corporation nor any of the affiliated entities had any corporate purpose of their own separate from the Debtor, B. J. McAdams, Inc.. Therefore, any claimed lien of Constellation Development Corporation in the proceeds of the 1977 Gates Learjet is hereby declared void.

LET JUDGMENT BE ENTERED ACCORDINGLY.

SO ORDERED.

Dated this 26th day of June, 1991.

WILLIAM A. HILL
United States Bankruptcy Judge
sitting by special designation

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 94-3658EALR

Constellation Development Corporation, Appellant,	*	Order Denying Petition for Rehearing and Suggestionfor Rehearing En Banc
vs.	*	
James F. Dowden, et al., Appellees.	*	

The suggestion for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

November 28, 1995

Order Entered at the Direction of the Court:
Michael E. Gaws
Clerk, U.S. Court of Appeals, Eighth Circuit

FILED
U.S. DISTRICT COURT
EASTERN DISTRICT ARKANSAS
AUG 12 1994
JAMES W. MCCORMACK, CLERK
By:_____
Dep Clerk

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

CONSTELLATION DEVELOPMENT CORP. PLAINTIFF

vs. LR-C-91-634

RICHARD L. SMITH, Trustee and
UNITED STATES EX REL, INTERNAL
REVENUE SERVICE DEFENDANT

ORDER

Pending before the Court are motions for rehearing (document #46) and to strike (documents #51 and 53) filed by Constellation Development Corporation. The Court has reviewed its Memorandum and Order entered in the case and the arguments filed in support of the motion for rehearing and finds that the motions must be denied.

Dated this 12th day of August, 1994.

Stephen M. Reasoner
U. S. DISTRICT JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

IN RE:

B. J. McADAMS, INC.,
Debtor. Bankruptcy No. 90-40695F
Chapter 7

RICHARD L. SMITH, TRUSTEE,
Plaintiff,

v.

UNION NATIONAL BANK OF LITTLE ROCK, et al.,
Defendants. Adv. No. AP90-4189

FILED
U.S. BANKRUPTCY COURT
EST & WST DISTS OF ARK
JUL 29 1991
PEGGY CARROLL, CLERK
By: Dep. Clerk

RICHARD L. SMITH, TRUSTEE,
Plaintiff,

v.

CONSTELLATION DEVELOPMENT CORP., et al.,
Defendants. Adv. No. AP 90-4207

ORDER

By Amended Motion filed July 8, 1991, in adversary 90-4207 and by Motion filed on July 16, 1991, in companion adversary 90-4189, the defendant, Constellation Development Corporation, Inc., asks this court to make additional findings

of fact and amend its Memorandum and Order of June 14, 1991. Essentially, it is the movants' position that the findings of fact distorted the evidence and that the evidence adduced at trial was insufficient to meet the preponderance of evidence standard necessary to the resulting judgment against Constellation Development Corporation, Inc..

At the outset it appears that the motions were not timely filed. Setting that procedural infirmity aside, however, it appears that the movant would have the court selectively review the evidence which it will not do. The findings of fact were those found by the court to be material but were by no means the only facts tending to substantiate the opinion. The entire record taken as a whole more than satisfies the standard of proof necessary for the conslusions reached.

Accordingly, the several motions to make additional findings of fact and/or amend the judgment are in all things DENIED.

SO ORDERED.

Dated this 24th day of July, 1991.

WILLIAM A. HILL
United States Bankruptcy Judge
sitting by special designation

Copies mailed 7-24-91 to:
Atty. Calvin Gibson
Patrick Harris, AUSA
Joseph Raymond, Tax Div.
Attorney James Smith

CONSTITUTION OF THE UNITED STATES

AMENDMENT 5

Due Process of Law.

No person shall ... be deprived of ... property, without due process of law ... .

AMENDMENT 7

Trial by Jury in Civil Cases.

In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury, shall be preserved, and no fact tried by a jury shall be otherwise re-examined in any court of the United States, than according to the rules of the common law.

11 U.S.C. BANKRUPTCY CODE

§ 101. Definitions

(31) "insolvent" means -

(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts os greater than all of such entity's property, at a fair valuation, exclusive of -

(i) property transferred, concealed, or removed with intent to hinder, delay, or defaud such entity's creditors; and

§ 105. Power of Court

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provisions of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

§ 361. Adequate Protection

(3) granting each other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

§ 362. Automatic Stay

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay providing under subsections (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay -

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; of

(2) with respect to a stay of an act against property under subsection (a) of this

section, if -

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

§§ 363. Use, Sale, or Lease of Property

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if -

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

§ 502. Allowance of Claims of Interests

(d) Notwithstanding subsection (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under sections 542, 543, 550, and 553 of this title or that is a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(i), 542, 543, 550, or 553 of this title.

§ 506. Determination of Secured Status

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless -

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

§§ 541. Property of the Estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following

property, whereever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interest of the debtor in property as of the commencement of the case.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(b) Property of the estate does not include -

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor; or

§ 542. Turnover of Property to the Estate

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

§§ 544. Trustee as Lien Creditor and as Successor to Certain Creditors and Purchasers

(a) The trustee shall have, as of the commencement of the case, and without regard to any

knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by -

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could obtain such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exitsts.

(b) The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

§ 547. Preferences

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property -

(4) made -

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

§ 548. Fraudulent Transfers and Obligations

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of filing of the petition, if the debtor voluntarily or involuntarily -

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date of such transfer was made or such obligation was incurred, indebted; or

BANKRUPTCY RULES

RULE 7001. Scope of Rules of Part VII

(2) to determine the validity, priority, or

extent of a lien or other interest in property, other than a proceeding under Rule 4003(d),

RULE 7008. General Rules of Pleading

(a) Applicability of Rule 8 F.R.Civ.P. Rule 8 F.R.Civ.P. applies in adversary proceedings. The allegation of jurisdiction required by Rule 8(a) shall also contain a reference to the name, number, and chapter of the case under the Code to which the adversary proceeding relates and to the district and division where the case under the Code is pending. In an adversary proceeding before a bankruptcy judge, the complaint, counterclaim, cross-claim, or third-party complaint shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge.

RULE 7009. Pleading Special Matters

Rule 9 F.R.Civ.P. applies in adversary proceedings.

28 U.S. CODE TITLES

§§ 157. Procedures

(a) East district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

(b)(1) Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a

case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

(2) Core proceedings, include, but are not limited to -

(F) proceedings to determine, avoid, or recover preferences;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(K) determinations of the validity, extent, or priority of liens;

(3) The bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under thsi subsection or is a proceeding that is otherwise related to a case under title 11. A detemination that a proceeding is no a core proceeding shall not be made solely on the basis that its resolution may be affected by State law.

§ 1254. Courts of Appeals; Certiorari; Certified Questions

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

§ 1334. Bankruptcy Cases and Proceedings

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

FEDERAL RULES OF CIVIL PROCEDURE

RULE 8. General Rules of Pleading

(a) Claims for Relief. A pleading which sets forth a claim for relief, whether an original claim, counterclaim, cross-claim, or third-party claim, shall contain (1) a short and plain statement of the grounds upon which the court's jurisdiction depends, unless the court already has jurisdiction and the claim needs no new grounds of jurisdiction to support it, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief the pleader seeks. Relief in the alternative or of several different types may be demanded.

RULE 9. Pleading Special Matters

(b) Fraud, Mistake, Condition of the Mind. In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

RULE 38. Jury Trial of Right

(a) Right Preserved. The right of trial by jury as declared by the Seventh Amendment to the Constitution or as given by a statute of the United States shall be preserved to the parties inviolate.

(b) Demand. Any party may demand a trial by jury of any issue triable of right by a jury by serving upon the other parties a demand therefor in writing at any time after the commencement of the action and not later than 10 days after the service of the last pleading directed to such issue. Such demand may be indorsed upon a pleading of the party.

RULE 39. Trial by Jury or by the Court

(b) By the Court. Issues not demanded for trial by jury as provided in Rule 38 shall be tried by the court; but, notwithstanding the failure of a party to demand a jury in an action in which such a demand might have been made of right, the court in its discretion upon motion may order a trial by a jury of any or all issues.

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF ARKANSAS, WESTERN DIVISION, RULE 32 I and II(a)

RULE 32. United States Bankruptcy Judges

I. References

All cases and proceedings arising under Title 11 of the United States Code or arising in or related to a case unter Title 11, brought pursuant to 28 U.S.C. §1334, §1412, or §1452, except personal injury or wrongful death tort claims, are referred to the bankruptcy judges for this district

as provided in 28 U.S.C. 157(a).

II. Proceedings

(a) The bankruptcy judge shall hear and determine all cases under Title 11 and all core proceedings arising under Title 11, or arising in a case under Title 11, which are referred under this Rule and shall enter appropriate orders and judgments.

ARKANSAS CODE ANNOTATED 4-59-204

4-59-204. Transfers fraudulent as to present and future creditors.

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

(1) With actual intent to hinder, delay, or defraud any creditor of the debtor; or

(2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

(i) Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(ii) Intended to incur, or believed or

reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

(b) In determining actual intent under subdivision (a)(1) of this section, consideration may be given, among other factors, as to whether:

(1) The transfer or obligation was to an insider;

(2) The debtor retained possession or control of the property transferred after the transfer;

(3) The transfer or obligation was disclosed or concealed;

(4) Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(5) The transfer was of substantially all the debtor's assets;

(6) The debtor absconded;

(7) The debtor removed or concealed assets;

(8) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) The transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

FILED
MAY 1, 1990

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DISTRICT

IN RE: B.J. McADAMS, INC. CASE NO. 90-40695F
Debtor(s) Chapter 7

UNITED STATES OF AMERICA PLAINTIFF

vs. CMS No. 90-682

B. J. McADAMS, INC. DEFENDANT

RESPONSE TO MOTION FOR RELIEF
FROM AUTOMATICE STAY

The Trustee, Richard L. Smith, P.A., by and through his attorneys, Smith Law Firm, Ltd., for his Response to Motion for Relief from Automatice Stay filed by the United States of America on behalf of the Internal Revenue Service states:

1. Trustee, Richard L. Smith, P.A., was appointed to serve as Chapter 7 Trustee in this proceeding by Order of this Court dated April 13, 1990.

2. The 1977 Gates Learjet 36A which is the subject of this Motion for Relief from Automatic Stay is property of the estate pursuant to 11 U.S.C. § 541.

3. The Trustee is engaged in seeking information regarding the validity of the lien of Constellation Development Corp., a lien which Internal Revenue Service, in its Motion, has acknowledged as disputed.

4. The Trustee has not been privided with

documentation by Union National Bank of its purchase money security interest lien.

5. The Trustee is without sufficient knowledge presently to make a judgment as to the validity of the security interest alleged by Midcoast Aviation.

6. There is equity in the Learjet available for creditors, the amount of which will be determined in accordance with the validity of the above mentioned liens.

7. The Trustee should be allowed to make a disposition of the 1977 Gates Learjet in the manner which is most advantageous to the estate and the creditors and distribute the proceeds as finally determined by this Court.

WHEREFORE, Trustee, Richard L. Smith, prays that this Court deny the Motion for Relief from Automatic Stay filed on behalf of Internal Revenue Service, that the Trustee be allowed to sell the Learjet free and clear of liens with the liens to attach to the proceeds of the sale in the priority as determined by this Court.

Respectfully Submitted;

By:_____

James E. Smith, Jr.
State Bar No 77128

SMITH LAW FIRM, LTD.
Ste 250 Spring Plaza Bldg
P. O. Box 3644
Little Rock, AR 72201
(501) 372-5745

FILED
JUNE 27, 1990
U.S. Bankruptcy Court
Little Rock, AR 72203

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DISTRICT

IN RE: B.J. McADAMS, INC. CASE NO. 90-40695F
Debtor(s) Chapter 7

UNITED STATES OF AMERICA PLAINTIFF

vs. CMS No. 90-682

B. J. McADAMS, INC. DEFENDANT

ORDER DENYING MOTION FOR RELIEF FROM STAY

Pursant to hearing held June 25, 1990, on the Motion for Relief from Stay filed by the United States of America, it is

ORDERED that the Motion is hereby denied without prejudice.

ROBERT F. FUSSELL
U. S. BANKRUPTCY JUDGE

DATE: June 26, 1990

cc: Thomas Pendowski
2101 Main St.
North Little Rock, AR 72114

Richard Smith, Esq.
P. O. Box 3644
Little Rock, AR 72203

Patrick Harris, AUSU
P. O. Box 1229
Little Rock, AR 72203

U. S. Trustee

FILED
Districts of Ark.
90 Dec. 19 PM 3:39
PEGGY CARROLL, CLERK
By:_____
Dep.Clerk

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

IN RE: B. J. McADAMS, INC. CASE NO. 90-40695F
Chapter 7

Debtor(s).

RICHARD L. SMITH, TRUSTEE PLAINTIFF

VS. AP NO. AP 904207

CONSTELLATION DEVELOPMENT, INC.;
UNITED STATES OF AMERICA, DEFENDANTS
INTERNAL REVENUE SERVICE

COMPLAINT

Richard L. Smith, Trustee, for his Complaint states that:

1.

He is the duly appointed and serving trustee in the Chapter 7 bankruptcy case of B. J. McAdams, Inc.

2.

The defendants are entities which the trustee believes to assert some claim against certain

property of the debtor's estate to wit: funds in the amount of $168,722.44 plus accrued interest less trustee's fees and commissions representing the net proceeds from the sale of personalty located on the premises of the debtor at North Little Rock, Arkansas.

3.

This Court has jurisdiction over this core proceeding pursuant to 28 U.S.C. §1334 and 157(b)(2)(k) and may enter appropriate orders and judgments in the matters.

4.

In order to determine the appropriate dispositon of the assets, the trustee must determine the nature, extent and validity of any liens asserted by the defendant upon the funds in question.

WHEREFORE, Richard L. Smith, Trustee, prays that this Court enter a judgment determining the nature, extent and validity of any lien claimed by Defendants upon the net proceeds from the sale of personal property located on the premises of the debtor at North Little Rock, Arkansas.

By:Signed by J. E. Smith, Jr.
James E. Smith, Jr.
State Bar No. 77128

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Little Rock, Arkansas 72201
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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

In re: B.J. McADAMS, INC.,	)	
	)	Case No.
Debtor.	)	90-40695F
	)	Chapter 7
	)	
RICHARD L. SMITH, TRUSTEE,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adv. No.
	)	AP904189
UNION NATIONAL BANK OF LITTLE ROCK, et al.,	)	
	)	
Defendants.	)	

ANSWER OF DEFENDANT INTERNAL REVENUE SERVICE

The Internal Revenue Service, by and through it counsel, hereby states the following in answer to the allegations of plaintiff's adversary complaint:

FIRST DEFENSE

The Internal Revenue Service is not a suable

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U.S. Bankruptcy Court
Est. & Wst. Dists of Ark.
Jan. 09, 1991
Peggy Carroll, Clerk
By: Dep. Clerk

entity and is not a proper party in an adversary proceeding brought to determine the nature and extent of federal tax liens. See In re Richard J. Morrell, 87-1 U.S.T.C. ¶9142 (N.D.Cal. 1986); In re Blue Water Bay, Inc., 89-2 U.S.T.C. ¶9566 (Bankr. M.D.Fla. 1989).

SECOND DEFENSE

1-2. Defendant admits the allegations contained in paragraphs 1 and 2.

3. Defendant admits that all defendants contend that they have a valid lien against the aircraft, but denies that all defendants, in fact, possess valid liens aircraft or the proceeds of its sale.

4. Defendant admits the allegations contained in paragraph 4.

WHEREFORE, the Internal Revenue Service requests this court to dismiss the complaint for lack of jurisdiction or, if the United States is substituted as a defendant, it requests the court to order that the federal tax lien of the United States be satisfied in full from the proceeds of the sale of the aircraft, for its costs in this matter, and forsuch further relief as the court deems just and proper.

CHARLES A. BANKS
United States Attorney

_____

PAT HARRIS
Asst.United States Attorney
Eastern District of Arkansas
P. O. Box 1229
Little Rock, AR 72203

J. JOSEPH RAYMOND
Tax Division
Department of Justice
P. O. Box 7238
Washington, D. C. 20044
(202) 514-6501
FTS 368-6501

FILED
U.S. Bankruptcy Court
Est. & Wst. Dists of Ark
Apr 4, 1991
PEGGY CARROLL, CLERK
By:_____
Dep.Clerk

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DISTRICT

IN RE:	B.J. McADAMS, INC. Debtor	CASE NO 90-40695F Chapter 7
RICHARD L. SMITH, TRUSTEE		PLAINTIFF
V.		AP NO. 90-4189
UNION NATIONAL BANK OF LITTLE ROCK et al.,		DEFENDANTS
RICHARD L. SMITH, TRUSTEE		PLAINTIFF
V.		AP NO. 90-4207
CONSTELLATION DEVELOPMENT CORPORATION et al.,		DEFENDANTS

PERTINENT PORTIONS OF

MOTION TO EXCLUDE EVIDENCE ON ISSUES
NOT PRESENTED BY THE PLEADINGS

Pages 1 and 2 of 8

Constellation Development Corporation ("CDC)

for its Motion states:

1. On or about December 3, 1990, Richard L. Smith, the Trustee in this Chapter 7 proceeding (the "Trustee"), caused to be filed as A.P. No. 90-4189 his "Complaint to Determine Nature, Extent and Validity of Lien" (the "Aircraft Lien AP") in connection with funds held by the Trustee from the same of a 1977 Gates Learjet 36(a). The body of the Trustee's complaint in the Aircraft Lien AP is four paragraphs summarized as follows:

From Pages 2 and 3 of 8

a. Plaintiff is the Trustee;
b. Trustee believes that the defendants may assert certain liens against the proceeds held by the Trustee from the sale of the Aircraft;
c. Defendants include all parties which filed of record with the FAA their liens against the Aircraft plus the Internal Revenue Service (the "IRS"); and
d. In order to determine the respective rights of the Defendants to the Aircraft or the proceeds from its sale, Trustee needs to determine the nature, extent, validity and priority of each of the defendant's liens against the Aircraft.

2. On or about December 19, 1990, the Trustee caused to be filed as A.P. No. 90-4207 his "Complaint" (the "personalty Lien AP") in connection with funds held by the Trustee from the sale of certain personalty located on the Debtor's premises in North Little Rock, Arkansas. The body of the Trustee's complaint in the Personalty Lien AP is four paragraphs summarized as follows:

a. Plaintiff is the Trustee;

b. Trustee believes that the defendants are entities which may assert certain liens against the proceeds held by the Trustee from the sale of the Personalty;

c. The Court has jurisdiction over this core proceeding pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(k); and

d. In order to determine the appropriate disposition of the assets, Trustee needs to determine the nature, extent, validity and priority of each of the defendant's liens against the Aircraft.

3. On December 21, 1990, Union National Bank ("UNB") filed its answer to the Trustee's complaint in the Aircraft Lien AP. UNB is not a party to the Personalty Lien AP. In its answer, UNB states that it contends that it holds a first priority security interest against the Aircraft proceeds but does not make any other allegations challenging the extent, validity or priority of the liens claimed by CDC.

4. On January 4, 1991, CDC filed in the Aircraft Lien AP its "Answer, Counterclaim and Cross-Claim of Constellation Development Corporation" wherein it asserts its lien against the Aircraft proceeds held by the Trustee.

5. On January 9, 1991, the IRS filed its Answers to the Trustee's complaints in both the Aircraft Lien AP and the Personalty Lien AP. In its Answers, the IRS generally denies that the other defendants have valid liens but does not state any factual allegations which challenge the lien of any defendant including CDC.

6. On January 14, 1991, UNB filed its Answer to CDC's Cross-Claim in the Aircraft Lien AP. The UNB Answer is in essence a general denial which makes no factual allegations relating to the claimed liens of CDC.

From Pages 4 and 5 of 8

9. On January 18, 1991, Trustee filed his Answer to CDC's Counterclaim in the Aircraft Lien AP. The Trustee's Answer is in essence a general denial and does not state any factual allegations relating to a possible challenge by the Trustee to the CDC lien claimed against the Aircraft proceeds.

10. On January 18, 1991, Trustee filed his "Amended Complaint to Determine Nature, Extent and Validity of Lien" in the Aircraft Lien AP. In essence, the only change of substance in the Amended Complaint is the change of the name of the Defendant "Internal Revenue Service" to the "United States of America".

From Page 5 of 8

11. On January 24, 1991, CDC filed its "Answer to Amended Complaint to Determine Nature, Extent and Validity of Lien"and its "Amended Cross-Claim against the United States of America" in the Aircraft Lien AP.

12. On January 25, 1991, UNB filed its answer to the Trustee's Amended Complaint in the Aircraft Lien AP. In its answer, UNB states that it contends that it holds a first priority security interest against the Aircraft proceeds but does not make any other allegations challenging the extent, validity or priority of the liens claimed by CDC.

13. In a letter dated January 29, 1991, counsel for the Trustee wrote to this Court regarding the setting for trial of various adversary proceedings in this Chapter 7 proceeding and specifically addresses the issues raised by both the Aircraft Lien AP and the Personalty Lien AP. The letter in essence states that both

adversary proceedings seek determination of the validity, extent and priority of lien claims relating to funds held by the Trustee. The letter mentions no other issues which will be tried as part of these adversary proceedings.

14. On February 19, 1991, the IRS in the Aircraft Lien AP filed its Answer to the Trustee's Amended Complaint and its Answer to CDC's Amended Cross-Claim. In its Answer to the CDC Amended Cross-Claim, the IRS sets forth two defenses to the Cross-Claim making certain conclusory allegations. Both of the defenses asserted by the IRS sound in fraud but the IRS has not set out any factual allegations describing with particularity the circumstances alleged to constitute this alleged fraud as required by F.R.C.P. Rule 9(b) and Rule of Bankruptcy Procedure 7009.

15. On March 7, 1991, present counsel entered an appearance for CDC in these proceedings.

16. Since present counsel have been involved in these proceedings, counsel for the IRS and the Trustee have indicated that there exists certain factual matters which if proven at trial would result in the disallowance of CDC's claim or the lien securing such claim. However, neither the Trustee nor the IRS has sought to amend their pleadings to state with the required particularity those factual allegations which would support such theories being advanced by the Trustee and the IRS. Nonetheless, it now appears that both the Trustee and the IRS intend to push forward with certain challenges to the CDC claim and/or lien at trial without first giving advance written notice to CDC in a proper pleading as required by law.

17. It would be fundamentally unfair to require CDC to appear at the trial of these cases and be prepared to defend against certain unspecified challenges being put forth by the opposing parties. It is a basic right of a defendant to be apprised by an opponent's pleadings of the nature of the complaints or accusations against him. This is especially the case when an opposing party states that a defendant has engaged in a "sham transaction" or is an "alter ego" but has provided no factual allegations to support such allegations.

18. CDC moves for entry of an Order excluding all evidence on all issues not raised by the pleadings filed herein. CDC further moves for an Order excluding all evidence of alleged fraudulent dealings or "sham transactions" or the existence of any alleged "alter ego" since neither the IRS nor the Trustee has pleaded any such alleged fraudulent activities with the factual particularity required by F.R.C.P. 9(b) and Bankruptcy Rule 7009.

WHEREFORE, Constellation Development Corporation moves for entry of an Order excluding all evidence on all issues not raised by the pleadings filed herein, for an Order excluding all evidence of alleged fraudulent dealings or "sham transactions" or the existence of any alleged "alter ego" due to the opposing parties' failure to comply with F.R.C.P. 9(b) and Bankruptcy Rule 7009, for its costs herein expended including a reasonable attorneys' fee in connection with this Motion, and for all proper relief.

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and

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Little Rock, AR 72201
Telephone (501) 375-1517
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By Signed by Gregory M. Hopkins
Gregory M. Hopkins

FILED
U.S. Bankruptcy Court
Est. & Wst. Dists. of Ark
Apr 4, 1991
PEGGY CARROLL, CLERK
By:_____
Dep.Clerk

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DISTRICT

IN RE:	B.J. McADAMS, INC. Debtor	CASE NO. 90-40695F Chapter 7
RICHARD L. SMITH, TRUSTEE		PLAINTIFF
V.		AP No. 90-4189
UNION NATIONAL BANK OF LITTLE ROCK et al.,		DEFENDANTS
RICHARD L. SMITH, TRUSTEE		PLAINTIFF
V.		AP NO 90-4207
CONSTELLATION DEVELOPMENT CORPORATION et al.,		DEFENDANTS

BRIEF IN SUPPORT OF MOTION TO EXCLUDE EVIDENCE ON ISSUES NOT PRESENTED BY THE PLEADINGS

Constellation Development Corporation ("CDC") submits this Brief in Support of its Motion to Exclude Evidence on Issues Not Presented by the Pleadings (the "Motion") for the Court's use and

consideration in ruling upon the Motion:

Factual Background of Controversy

The factual background of this dispute is set forth in detail in the Motion and is incorporated herein by reference.

Page 2

Argument

This dispute is brought before this Court because counsel for Richard L. Smith, the Trustee in this Chapter 7 proceeding (the "Trustee"), and counsel for the Internal Revenue Service (the "IRS") have stated to counsel for CDC that certain factual matters exist which if proven at trial would invalidate either the claims or the liens (or perhaps, both) asserted by CDC to the funds held by the Trustee. However, the pleadings in these proceedings in their present state do not disclose any basis for such a disallowance since the circumstances which might support such relief have not been pleaded in proper form with requisite particularity as required by law.

F.R.C.P. Rule 8(a) in pertinent part provides:

> (a) Claims for Relief. A pleading which sets forth a claim for relief ... shall contain ... (2) a short and plain statement of the showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief the pleader seeks. Relief in the alternative or of several different types may be demanded.

F.R.C.P. Rule 9(b) in pertinent part provides:

(b) Fraud, Mistake, Condition of the Mind. In all averments of fraud, the circumstances constituting the fraud or mistake shall be stated with particularity....

F.R.C.P. Rules 8(a) and 9(b) are made expressly applicable to adversary proceedings by Rules of Bankruptcy Procedure 7008 and 7009.

In these proceedings, neither the IRS nor the Trustee has set forth in any pleading any facts showing their entitlement to any Order disallowing CDC's claims and/or liens nor ahve they made an adequate demand for judgment for the relief they apparently will

now seek. Further, even though the IRS has stated that the CDC transactions were a "sham" and that CDC is the "alter ego" of Bob McAdams individually, neither the IRS nor the Trustee has pleaded with the requisite particularity the circumstances which they contend would sustain these conclusory allegations. CDC is entitled to have advance notice of the allegations against it in order to properly prepare for trial. Since it has not been afforded such adequate notice by appropriate pleading complying with F.R.C.P. Rules 8(a) and 9(b) and Bankruptcy Rules 7008 and 7009, and for the reasons set forth herein, CDC's Motion to Exclude should be granted.

A summary of the legal principles applicable to this situation is set forth in one of the leading legal treatises which states as follows:

> The matters of proof offered in the discharge of the burden of proof and in support of a claim or defense must be admissible as evidence in courts

of justice, and should ordinarily be confined to the case as presented by the facts pleaded upon which issue is joined, for it is the general rule that questions that are not within the issue presented by the pleadings may not be determined by the courts. While the party should be permitted to prove every fact alleged by him not inconsistent with admissions, express or implied, ordinarily he will be precluded from proving any fact not alleged for however full and convincing the proof may be as to any essential fact, that alone is insufficient unless the fact is averred. Evidence of matters which are outside the issues raised by the pleadings is irrelevant and inadmissible. The reason for the rule is that the opposing party shall be specifically advised of what he is called upon to answer, so that he may be enabled to

properly make out his case, and that he may not be taken by surprise in the testimony at the trial, for proof without allegation is as impotent as allegation without proof.

61A Am. Jur 2d, Pleading, §366 (Footnotes and citations omitted). Emphasis supplied.

The above principles have been repeatedly applied in Arkansas courts since at least 1844. See, e.g., Brodie et al. v. Skelton, 11 Ark. 120

(1844) where the Arkansas Supreme Court said:

> "If their rights were sought to be thus vitally affected, there can be no doubt but that they were entitled to be apprized of it, so they could be prepared to make their defence, and if possible prevent so great a calamity."

In reversing a lower court decision based upon evidence admitted into evidence over the appellant's objection, the Arkansas Supreme Court has held that it is a basic right of a defendant to be apprised by a plaintiff's pleadings of the nature and extent of the complaints and allegations against him. Dorris v. Dorris, 249 Ark. 580, 460 S.W.2d 98 (1970).

In this case, at most, all that has been alleged in opposition to the lien claims of CDC is that Bob McAdams is the "alter ego" of CDC and that CDC engaged in "sham" transactions with the Debtor because funds belonging to Bob McAdams were the source of the funds loaned by CDC to the Debtor. However, under Arkansas corporate law, even if the funds loaned by CDC to the Debtor were all funds belonging to Bob McAdams (a point which is partially disputed) and even if CDC were the "alter ego" of CDC (which is also disputed), this does not support the disallowance of CDC's claims nor does it impose liability upon CDC or Bob McAdams for the debts of the Debtor. See, e.g., Ft. Smith Light & Tractor Co. v. Kelley, 94

Ark. 461, 127 S.W. 975 (1910); Atkinson v. Reid, 185 Ark. 301, 47 S.W.2d 571 (1932); Rounds & Porter Lumber Co. v. Burns, 216 Ark. 288, 225 S.W.2d 1 (1949); and Mid-State Homes, Inc. v. Knight, 237

Ark. 802, 376 S.W.2d 556 (1964). Thus, in order for the Trustee and the IRS to prevail in their challenge to CDC's lien claims, they will have to present evidence at trial outside of the issues presented by the pleadings. Such a presentation is objected to by CDC and would violate the basic rights of CDC to be apprised of the complaints and allegations against.

The need to plead a cause of action as a prerequisite to being permitted to introduce evidence on an issue is even more fundamental where the issue sounds in fraud. This is due to the particularity requirement of Rule 9(b) as set forth above. For a case involving an attempt to assert liability against officers and directors of a Debtor corporation which was dismissed for failure to plead fraud with particularity as required by Rule 9(b), see Unimobil 84, Inc. v. Spurney, 797 F.2d 214 (5th Cir. 1986).

Conclusion

This dispute presents a classic case of where the opposing side attempts to hide all of its cards until the last minute. The purpose of such tactics is to unfairly require the defendant to prepare to defend issues which may not have even been articulated prior to walking into the courtroom. This requires the defense to make arrangements to bring in potentially unnecessary witnesses, including out-of-state expert witnesses, and to use expensive

attorney time preparing for issues which may not even be raised. These kinds of tactics should not

be tolerated by this Court.

Although it is anticipated that such an argument will be advanced by opposing counsel, it is not sufficient that opposing counsel may have mentioned these unpleaded matters in informal conversations or in discovery responses. Without a formal pleading of record, the defense cannot test the sufficiency of the pleadings by Motion to Dismiss, Motion for Summary Judgment, and the like. Although the result may seem harsh, this Court should uphold the interests of justice and fundamental fairness and grant CDC's Motion.

Respectfully submitted,

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By Signed by Gregory M. Hopkins
Gregory M. Hopkins

CERTIFICATE OF SERVICE

I, Gregory M. Hopkins do hereby certify that I have served a copy of the foregoing upon Mr. James E. Smith, Mr. J. Joseph Raymond and Mr. John Fink by regular postage prepaid United States Mail this 5th day of April, 1991.

Signed by Gregory M. Hopkins
Gregory M. Hopkins

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U.S. Bankruptcy Court
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PEGGY CARROLL, CLERK

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

IN RE: B. J. McADAMS, INC. CASE NO 90-40695F
Chapter 7

Debtor(s).

RICHARD L. SMITH, TRUSTEE PLAINTIFF

VS. AP 90-4189

UNION NATIONAL BANK OF
LITTLE ROCK, CONSTELLATION DEFENDANTS
DEVELOPMENT CORPORATION and
UNITED STATES OF AMERICA

RICHARD L. SMITH, TRUSTEE PLAINTIFF

VS. AP 90-4207

CONSTELLATION DEVELOPMENT, INC.
and UNITED STATES OF AMERICA, DEFENDANTS
INTERNAL REVENUE SERVICE

PERTINENT PORTIONS OF

BRIEF SUPPLEMENTING THE
PRETRIAL INFORMATION SHEET
OF RICHARD L. SMITH, TRUSTEE

From Pages 1 & 2 of 19

The Trustee, Richard L. Smith, respectfully submits this trial brief to set forth the legal authorities which will govern the trial of this matter and the facts which the Trustee anticipates will be proven at trial. This brief will demonstrate that the liens asserted by Constellation Development Corporation, Inc. (hereinafter Constellation) and Parthenon Insurance Co., Ltd. (hereinafter Parthenon) are the result of sham loans and should be set aside. Constellation was the alter ego of B. J. McAdams, Individually and the debtor B. J. McAdams, Inc. (hereinafter McAdams, Inc.). The funds used to fund the putative loan from Constellation to McAdams, Inc. were actually the funds of McAdams, Inc.

By any test, these companies had no existence part from and independent of Bob McAdams, who used his domination of them to conduct a shell game with the most sizable asset he owned, the Gates Learjet. The loans underlying Constellation's lien claims are a sham and a fraud on creditors and its liens should be set aside.

STATEMENT OF LEGAL AUTHORITIES

> A court can pierce the corporate veil if 'there are substantial reasons for doing so' after weighing: (1) the amount of respect given to the separate entity of the corporation by its shareholders; (2) the degree of injustice vested on the litigants by recognition of the corporate entity; and (3) the fraudulent intent of the incorporators.

Laborers' Pension Trust Fund v. Weinberger Homes, 872 F.2d 702, 704 (6th Cir.1988).

> Factors to be considered include undercapitalization of the corporation, the maintenance of separate books, the separation of corporate and individual finances, the use of the corporation to support fraud or illegality, the honoring of corporate formalities, and whether the corporation is merely a sham."

Laborers', 872 F.2d at 704-705.

> An alter ego analysis must start with an examination of factors which reveal how the corporation operates and the

> particular defendant's relationship to that operation. The factors include (1) whether the corporation was adequately capitalized for the corporate undertaking; (2) whether the corporation was solvent; (3) whether dividends were paid, corporate records kept, officers and directors functioned properly, and other corporate formalities were observed; (4) whether the dominant shareholder siphoned corporate funds; and (5) whether in general, the corporation simply functioned as a facade for the dominant shareholder.

Dewitt Trust Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 686-687 (4th Cir.1976).

The Dewitt court indicated that any combination of the above factors would justify the disregard of the corporate entity while also considering the overall injustice or unfairness of the situation.

Factors to be considered in determining whether to disregard the corporate veil include not only whether the entity has been used to work a fraud or injustice in contravention of public policy, but also: (1) whether there was failure to collect paid in capital; (2) whether the corporation was grossly undercapitalized; (3) the nonissuance of stock certificates; (4) the sole ownership of stock by one individual; (5) the use of the same office or business location; (6) the employment of the same employees or attorneys; (7) the use of the

corporation as an instrumentality or business conduit for an individual or another corporation; (8) the diversion of corporate assets by or to a stockholder or other entity to the detriment of creditors, or the manipulation of assets and liabilities in another; (9) the use of the corporation as a subterfuge in illegal transactions; (10) the formation and use of the corporation to transfer to it the existing liability of another person or entity; and (11) the failure to maintain arms length relationships among related entities.

Federal Deposit Ins. Corp. v. Allen, 584 F.Supp. 386, 397 (E.D.Tenn.S.D.1984).

See G.M. Leasing v. United States, 514 F.2d 935 (10th Cir.1975), Valley Finance, Inc. v. United States, 629 F.2d 162 (D.C.Cir.1980), DeWitt Truck Brokers v. W. Ray Flemming, 540 F.2d 681 (4th

Cir.1976), United States v. Pisani, 646 F.2d 83 (3rd Cir.1981).

> Courts have established certain criteria to be considered in determining whether piercing the corporate veil is appropriate. These include: (1) the absence of corporate formalities which are part of normal corporate existence, i.e., the election of directors, keeping of corporate records; (2) inadequate capitalization; (3) personal use of corporate funds; and (4) perpetration of fraud through the corporate vehicle."

Aries Ventures Ltd. v. Axa Finance S.A., 729 F.Supp. 289, 296

(S.D.N.Y.1990).

> A corporate entity will be disregarded and the veil of limited liability pierced when two requirements are met: First, there must be such unity of interest and ownership that the separate personalities of the corporation and the individual (or other corporation) no longer exist, and second, circumstances must be such that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice.

Van Dorn Co. v. Future Chemical and Oil Corp., 753 F.2d 565, 569-570 (7th Cir.1985).

> Although an intent to defraud creditors would surely play a part if established, the Illinois test does not require proof of such intent. Once the first element of the test is established, either the

> sanctioning of a fraud (intentional wrongdoing) or the promotion of injustice, will satisfy the second element.

Van Dorn, 753 F.2d at 570.

> To apply the alter ego doctrine, the Court must determine (1) that there is such unity of interest and ownership that the separate personalities of the corporation and the individuals no longer exist and (2) that failure to disregard the corporation would result in fraud or injustice.

Flynt Distributing Co., Inc. v. Harvey, 734 F.2d 1389, 1393 (9th Cir.1984).

> The application of the alter ego theory to pierce the corporate veil is a 'tool of equity . . . appropriate utilized when the Court must prevent fraud, illegality or injustice, or when recognition of the corporate entity would defeat public policy or shield someone from liability from the crime.

Reverse Vending Associates v. Tomra Systems VS, Inc., 655 F.Supp. 1122, 1128 (E.D.Pa.1987). See Publicker Industries v. Roman Ceramics, 603 F.2d 1065 (3rd Cir.1979), Zubik v. Zubik, 384 F.2d 267 (3rd Cir. 1967).

> Such circumstances justify piercing the corporate veil because the limited liability inherent in the corporation's separate existence is misused as a means or intermediary for the perpetration of fraud, illegality or injustice.

Reverse, 655 F.Supp. at 1128.

> Courts will disregard the corporate form and impose liability on a shareholder when a shareholder has used control of a corporation to further his own, rather than the corporation's business.

Aries Ventures Ltd. v. Axa Finance S.A., 729 F.Supp. 289, 296 (S.D.N.Y. 1990).

> In an appropriate case and in furtherance of the ends of justice, a corporation and the individual or individuals owning all its stock and assets will be treated as identical, the corporate cloak being disregarded where

> used as cover for fraud or illegality and the corporation and individual or individuals owing all its stock and assets will be treated as identical.

Federal Deposit Ins. Corp. v. Allen, 584 F.Supp. 386, 397 (E.D.Tenn.S.D.1984). See Corporation, 18 Am.Jur.2d §14, p. 599, Annot., 63 A.L.R.2d 1051, Bangor Punta Operations v. Bangor & A.R. Co., 417 U.S. 703 (1974).

> When a corporation is dominated by an individual or individuals not only as to finance but also as to policy and business practices so that the corporation has no mind, will, or existence of its own and this domination is used to commit a wrong, or fraud or perpetrate a violation of statutory or positive legal duty the corporate veil will be pierced.

Federal Deposit Ins. Corp. v. Allen, 584 F.Supp. 386, 397 (E.D.Tenn.S.D.1984). See Mayo v. Pioneer Bank & Trust Co., 274 F.2d 320 (5th Cir.1960).

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By: Signed by J. E. Smith, Jr.
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MR. HOPKINS: The other issue that was raised in response was that no proof of claim had been filed by Constellation. As Your Honor knows, the filing of a proof of claim is not -- is not necessary at this point, and there are some practical reasons why a client or a party would not want to do so such as the possibility of waiving a jury trial right as recognized by the Supreme Court in Granfinanciera so I submit that the non-filing of a proof of claim is not relevant to the determination. Thank you, Your Honor.

THE COURT: Before you sit down, Mr. Hopkins, tell me what new issue was raised by the counter-claim and cross-claim?

MR. HOPKINS: The new issue which was raised by the counterclaim and cross-claim of Constellation, Your Honor, was the nature, extent and validity of the Constellation lien against the proceeds held by the trustee.

In essence, the trustee comes to the Court in a four-paragraph complaint and says, "I am the trustee. I hold funds. I have made an inquiry and determined that certain people may hold claims against these funds, and I request the Court to determine the nature, extent and validity of those liens and give me direction on how to disburse the funds."

Constellation, at that point properly came in and counterclaimed against the trustee saying "Court, please determine that I have a valid first-priority lien against

those assets." A cross-complaint was also filed against the competing lien claimant to the personalty proceeds, the IRS.

THE COURT: But by your counterclaim and cross-claim, what you did was merely affirm the trustee's complaint allegation. The trustee asserted that there are entities, specifically and including Constellation Development, that counterclaim and cross-claim you say, "Yes, indeed we do."

MR. HOPKINS: That's correct. We -- the new fact that would be introduced into that is that we have a valid first lien. The trustee doesn't recognize that we have a valid first lien, just that we may be claiming a lien.

THE COURT: All right.

MR. HOPKINS: Thank you, Your Honor.

THE COURT: Well, it's the position of the Court that there is essentially no new issue raised by the counterclaim or cross-claim. It was merely a restatement of the issues already joined by the complaint and respective answers. Accordingly, the motion for default judgment is denied.

THE COURT: Now that brings us to the threshold in limine motions. The first is a motion to exclude evidence on issues not in the pleadings. That motion was filed by Constellation Development. Also, it asserts that the two adversaries today deal with certain lien claims in an aircraft as well as certain lien claims and various items of personalty together

with the proceeds. It asserts that in response to CDC's amended cross-claim and counterclaim, the Internal Revenue Service makes conclusionary allegations of fraud, but failed to set up the particular circumstances and, accordingly, CDC asks the Court to exclude all evidence of fraudulent dealings or sham transactions allegedly (sic) to have been committed.

Mr. Hopkins.

MR HOPKINS: May it please the Court, I believe the Court correctly states the focus of our motion. The factual background framing this issue is set forth in the motion to exclude evidence. In essence, at all times the pleadings in this -- with one exception, which I'll address -- at all times the pleadings in this particular -- these two particular APs have been addressed solely to a determination of lien priorities. There have been no allegations, with the one exception of the conclusory allegations, of sham transactions or, quote, unquote, "alter-ego" made by the IRS.

With the exception of those allegations, there has been no factual basis pled to disallow either the Constellation claim or the Constellation lien on any basis that would, say, be a fraudulent conveyance, equitable subordination, any number of other issues.

We contend that Rule 8 requires the trustee and-or the IRS if they intend to prosecute such action to set for a short, plain statement showing they're entitled to that

relief, and by prayer, demand what relief they request, neither of which has happened.

We further state that Rule 9(b), since the complaints do not contain anything but conclusory allegations of fraud in the two instances, fail to meet the particularity requirement required. By a review of the pleadings no one could determine what the actual challenge to Constellation is.

Only this morning, there was a complaint -- excuse me, not -- there was a supplemental brief filed this morning by the trustee citing legal authority for its position to disallow the Constellation claim. Pages 12 through 17 contain the trustee's legal authority. In the legal authority, there are some eight or nine citations there quoted, all of which say that it requires fraudulent intent of the incorporators. It's the use of the corporation to support fraud, et cetera, et cetera.

So what we now have here at this late date is the trustee and the IRS attempting to advocate some cause of action not articulated or based on conclusory allegations of fraud which we have not had adequate notice of the true thrust of that. We think that the reason -- even though they may have told us in discovery that they would come forward with certain allegations along these lines, that doesn't satisfy the test. We should have been able to have the right prior to being in trial to test any allegations of fraud or illegality

or any motion to disallow our claim by a motion to dismiss, motion for summary judgment, or similar pleading.

We should have had the right to engage in meaningful discovery and without knowing the particulars of what they say constitutes this late date fraud, we have been deprived of our opportunity to know what witnesses we needed to have here in court today.

On a different thrust, if the trustee and-or the Internal Revenue Service is attempting to advocate a fraudulent conveyance action at this point, then under the Granfinanciera case and under the United Bank of — United Missouri Bank case, there may be certain jury trial issues raised.

Without these issues being framed and properly before the Court, there is no way that our client can have a meaningful forum within which to decide whether he wants to request jury trial or not.

Finally, if the IRS is trying to take away the jury trial right or to do this, it may violate the Fifth Amendment Due Process Clause.

In summary, the authorities which we have cited stand for the proposition that proof without allegation is just as impotent as allegation without proof, and we'd request the Court, since the representations to the Court by pleading and by letter is that this is a lien AP to determine the extent

and validity and who gets the proceeds, that it stay a lien AP, and if there are other proceedings which they want to advocate, that they do so by other proceeding.

THE COURT: Well, when a party plaintiff raises any allegation of lien validity, what does that mean to you?

MR. HOPKINS: What that means to me is he says he has money.

THE COURT: You suggest it means merely an issue of perfection or lack of perfection or priority?

MR. HOPKINS: Yes, Your Honor. I -- in my mind, what that means is, first of all, we have got to show that we have a lien, a UCC-created security interest consistent with Article -- Section 9203 of the Code. And once we meet that hurdle -- in this case we're dealing with personal property, so I'll restrict my comments to that.

But we first have to show we have a valid lien complying with 9203. Then we have to show that that lien has priority over any competing claimants by perfection or by exception to perfection, whatever, and that's what we think this AP goes to. This is not an equitable subordination case. It's not fraudulent conveyance case. At least the pleadings don't disclose that. It's not a preference case at this state, Your Honor.

THE COURT: All right.

MR. HOPKINS: Thank you, Your Honor.

MR. JAMES SMITH: Your Honor, I believe the Court in its question of Mr. Hopkins put its finger on the essence of what we're here for today.

We ask that the Court determine the extent and validity of liens, any liens against the aircraft or certain other items of personalty which are assets of the estate. Without a filed proof of claim we can only surmise as to exactly what they are claiming and what the basis of it is, I think through discovery, which again was delayed twice by the defendants, the Constellation defendant in this case, alleging pending grand jury investigations among other things.

We are hamstrung in perhaps formulating the pleadings -- in amending the pleadings to formulate more specifically what I would have preferred to put before the Court, but we certainly think that the issues are before the Court. Once they put on proof of their claim, we have the right to examine and attack any claim they may have. It's the purpose of this hearing today.

I think the record is clean as far as what we've asked the Court to do, the response they've had up until today, and discovery that has gone forward. I think the motion is ill-taken. I don't think it raises any meaningful issues here today, given the nature of the pleading. I haven't asked that the plane be subordinated or the plane be disallowed. That may come if they file -- if we prevail today

on the security interests, and they file an unsecured claim. I might be -- that would be the appropriate time for me to ask that that claim be disallowed.

THE COURT: By your complaint, as I read it, you're not seeking the recovery of anything. You're simply seeking this Court's determination as to the ranking or priorities of various lien claimants.

MR. JAMES SMITH: Or validity of liens, yes, sir. And they may well have an unsecured claim. That issue has not been addressed yet. It's premature. And, you know, I wouldn't even -- wouldn't even want to try to address that in these proceedings. I think they're premature and not relevant to the extent and validity of the lien, which is what we're trying here today.

THE COURT: All right. Mr. Raymond.

MR. RAYMOND: Your Honor, going back to very same amended answer to the cross-claim that I put in the U. S. Mails on February 14th, 1991, I'll read to you the first defense I have listed there.

"Cross-claim plaintiff, Constellation Development Corporation is the alter-ego of B. J. McAdams, who is the sole shareholder of debtor B. J. McAdams, Incorporated and-or Robert L. McAdams, the son of B. J. McAdams."

Second defense:

> "The two alleged loans from cross-claim plaintiff Constellation Development Corporation to debtor B. J. McAdams, Incorporated, which formed the basis of Constellation's claim against the funds at issue in the above-referenced adversary proceeding were sham transactions.
> "In each of the aforementioned loan transactions, Constellation was used as a mere conduit to funnel funds from B. J. McAdams, via various entities he controlled, to Constellation and then back to B. J. McAdams, Incorporated."

I think Mr. Hopkins is a pretty intelligent individual, Your Honor, and I really did give it an honest shot to put him on notice what I was trying to do, and I'm just -- I'm surprised at this motion. Thank you.

THE COURT: All right, counsel. With regards to that particular motion, I believe that the essential focus of the matter in issue is, to be precise, the priority of various liens claimed to exist in the subject aircraft and various other items of personalty. To determine that, one has to, of course, preliminarily determine the nature and extent of the claim of lien.

I believe that generally that allegation does raise and bring into question anything that might impair the nature or validity of a lien. Secondly, I do believe that the

TR 19, Lines 1 - 6

specific references made in the United States' first and second defense are sufficient and reasonably specific to put the Constellation Development Corporation on notice and, accordingly, the motion for exclusion of evidence bearing on questions of alter-ego and insider dealings, if you will -- that is, sham transaction -- is denied.

TR 33, Lines 11 - 20

MR. HOPKINS: Yes, Your Honor, there is one other matter. In consulting with my client, and as a result of statements this morning about the issues which have not been raised by the pleadings relating to fraudulent conveyances or other avoidance actions, my client has directed me to make demand for trial by jury on those issues to which the client would be entitled to trial by jury.

THE COURT: Denied.

MR. HOPKINS: Thank you, Your Honor.

THE COURT: See you at 1:30, gentlemen.

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

IN RE: B.J. McADAMS, INC. CASE NO. 90-40695F
Chapter 7
Debtor(s) PLAINTIFF

RICHARD L. SMITH, TRUSTEE

VS. AP 90-4189

UNION NATIONAL BANK OF LITTLE ROCK
CONSTELLATION DEVELOPMENT CORPORATION
AND UNITED STATES OF AMERICA DEFENDANTS

RICHARD L. SMITH, TRUSTEE PLAINTIFF

VS. AP 90-4207

CONSTELLATION DEVELOPMENT, INC.
AND UNITED STATES OF AMERICA,
INTERNAL REVENUE SERVICE DEFENDANTS

Pertinent portions of:

POST-TRIAL BRIEF OF RICHARD L. SMITH, TRUSTEE

From Page 1 of 25.

Richard L. Smith, Trustee for the Chapter 7

FILED
U.S. BANKRUPTCY COURT
EST. & WST. DISTS. OF ARK.
May 10, 1991
PEGGY CARROLL, CLERK

estate of B.J. McAdams, Inc. submits the following for his post-trial brief in the two above referenced adversary proceedings which were consolidated for trial which began April 8, 1991.

ISSUES PRESENTED

From Page 10 of 25.

1. When a corporation is so dominated by an individual or individuals, not only as to finance but also as to policy and business practices, so that the corporation has no mind, will, or existence of its own and this domination is used to commit a wrong, or fraud or perpetrate a violation of statutory or positive legal duty, should the corporate veil be pierced?

2. When the corporate veil between affiliated corporations and the debtor has been pierced, should the validity of the security interest of this corporation be negated as invalid, as a claim of the debtor?

From Page 23 of 25.

McAdams is unquestionably the alter ego of Constellation and Parthenon by satisfying virtually all the factors of any test taken from any circuit.

CONCLUSION

From Pages 23 and 24 of 25.

B. J. McAdams, Inc., which is demoninated by Bob J. McAdams (B.J. McAdams) is the alter ego entity of Constellation Development Corporation and Parthenon Insurance Company, Ltd. The purpose in

creating Constellation and Parthenon was to fraudulently evade the minimum insurance requirements for trucking firms and defraud McAdams' secured creditors in the event of bankruptcy. The testimony and evidence at trial conclusively establish that McAdams, Constellation and Parthenon are all one in the same corporation. This is a case where the corporate veil should be pierced and the separate corporate identities should be disregarded. Constellation's security interest is invalid and subordinate to McAdams' other legitimate secured creditors.

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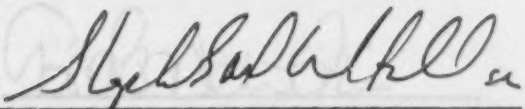
Respectfully Submitted:
CONSTELLATION DEVELOPMENT CORP.



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